THE BATTLE BETWEEN THE COURTS AND COVERAGE – HOW TO HANDLE THE INNOCENT CO-INSURED

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I. Introduction

As lawyers, we are trained from the beginning of our law school education to analyze the meaning of the written word. We are also instructed to take great care that any document we draft clearly defines each party's responsibilities and duties. A poorly drafted phrase or sentence or misplaced word can dramatically alter an individual's rights under a contract.

In no area of insurance law is this principal more evident than the issue of coverage for the innocent co-insured. The insured's right to recover and the carrier's right to deny coverage is often determined by a two or three-letter word preceding the word insured. For example, whether a wife, who is completely innocent of her husband's attempt to burn down their home, has any rights to recover under the homeowner's policy can be determined by the words "an," "the" or "any."

Because of the harshness of potentially denying an innocent co-insured of the right to recover, the courts have also compelled coverage even when the policy language excludes recovery for any insured. In these instances, the courts have focused upon the severability of interest clause.

This paper will describe the development of the law on coverage for innocent co-insureds and the policy considerations that affect courts' interpretations of policies. Then this paper will examine how articles and modifiers interact to determine coverage, and how a severability of interests clause may or may not determine whether the insurer owes coverage to the innocent co-insured, and how the language of the policy determines coverage in various fact patters.

II. Historical Development Of The Law

Seventy years ago, when courts were asked to determine an insurance carrier's obligation to an innocent co-insured, they assumed that the insurance contract was considered joint. The innocent co-insured could not recover in most circumstances where one insured committed an excluded act. See Leane English Cervin, *The Problem of the Innocent Co-Insured Spouse: Three Theories on Recovery*, 17 Val. U. L. Rev. 849, 857 (1983); *Matyuf v. Phoenix Insurance Co.*, 27 Pa.D&C2d 351 (1933). Under the old view, courts assumed that the phrase "the insured" meant the named insured, and that it meant the same thing throughout the contract. The old view was based on archaic concepts, such as marital unit and tenancy by entirety. It was a harsh and unfair rule because it denied coverage in almost all circumstances.

In response to the harshness of the old rule, another doctrine developed. This doctrine was called the "rebuttable presumption theory," and allowed the innocent co-insured spouse to rebut the presumption of a joint obligation by proving that his/her interest in the property was severable. *Hoyt v. New Hampshire Fire Insurance co.*, 92 N.H. 242, 29 A.2d 121 (1942). The innocent co-insured spouse had the burden of demonstrating a separable interest in the insured property. The flaw in the rebuttable presumption theory, however, was essentially the same as in the old rule: it was based upon a link between co-ownership of the property and a joint contractual obligation. This analysis, under a property rationale, ignored the extent of the parties' rights and duties as dictated by the insurance contract.

Under the current majority view, the responsibility or liability for the fraud is several and separate rather than joint, and one spouse's fraud cannot be attributed or imputed to the other. *Howell v. Ohio Casualty Co.*, 124 N.J.Super. 414, 307 A.2d 142 (1973), *modified*, 130 N.J.Super. 350, 327 A.2d 240 (1974) (*per curiam*). Under the majority rule, the public policy against imputing fraud liability to an innocent person is stronger than the potentiality of a benefit to the wrongdoer.

This approach does not mean that coverage of the innocent co-insured cannot be avoided. Insurers can still avoid paying claims to the innocent co-insured if they clearly and consistently state this intention in the insurance contract. However, the "tables have turned," and it is now the burden of the insurer to establish that coverage should be denied.

III. How clauses in the insurance contract interact to determine whether there is coverage for the innocent co-insured.

A. Use of the articles modifying insured

Resolution of policy coverage with regard to the innocent co-insured frequently rests on interpretation of the articles "an," "any," and "the." *Compare Vance v. Pekin Insurance Company,* 457 N.W.2d 589 (Iowa 1990); *Dolcy v. Rhode Island Joint Reinsurance Association,* 589 A.2d 313 (R.I. 1991); *Osbon v. National Union Fire Insurance Company,* 632 So.2d 1158 (La. 1994); *Watson v. United Services Automobile Association,* 566 N.W.2d 683 (Minn. 1997); *State Farm Fire & Casualty Insurance Company v. Miceli,* 518 N.E.2d 357 (Ill. 1987).

In *Vance v. Pekin Insurance Company,* 457 N.W.2d 589 (Iowa 1990), Mrs. Vance, the plaintiff, argued that she was covered for her loss after her husband burned down their home. The policy contained the following language:

In this policy, "you" and "your" refer to the "named insured" shown in the declaration and the spouse if a resident of the same household. "We," "us" and "our" refer to the company providing this insurance. In addition, certain words and phrases are defined as follows:

> . . .
> 3. "insured" means you and residents of your household who are:
> a. your relatives; or
> b. other persons under the age of 21 and in the care of any person named above.
>
> . . .
> We do not insure for loss caused directly or indirectly by any of the following: such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss.
> . . .
>
> 8. Intentional Loss, meaning any loss arising out of any act committed:
> a. by or at the direction of *an* insured. [Emphasis added.]

The parties agreed that the case turns on whether the italicized word "an" before the word "insured" was ambiguous. The test for ambiguity was whether a reasonable person would read more than one meaning into the word. The Iowa Supreme Court held, that measured by this test, the word "an" was not

ambiguous. The innocent co-insured was therefore denied coverage under this policy.

In *Dolcy v. Rhode Island Joint Reinsurance Association,* 589 A.2d 313 (R.I. 1991), the Supreme Court of Rhode Island held that whether an innocent co-insured may recover under a policy depended upon whether an innocent co-insureds' obligation not to commit fraud or arson was considered to be joint rather than separate. The policy read, "We do not provide coverage for an insured who has: a) intentionally concealed or misrepresented any material fact or circumstances or b) made false statements or engaged in fraudulent conduct; relating to this insurance."

The defendant insurance carrier argued that if it had used the words "the insured," then the insureds' obligations would have been separate. By distinction, "an" insured connotes a joint obligation to refrain from intentional losses. The plaintiff argued that the word "an" in and of itself was ambiguous. Further, the words "the" and "an" were used interchangeably throughout the policy. The Rhode Island Supreme Court held that after examining the exclusion clause and the entire policy and found that it was not ambiguous. Both insureds had a joint obligation to refrain from causing intentional loss because the carrier did not insure for such a loss.

In *Osbon v. National Union Fire Insurance Company,* 632 So.2d 1158 (La. 1994), the Louisiana Supreme Court addressed the issue of whether an innocent co-insured was barred from recovering under a fire insurance policy because her home was destroyed by a fire intentionally set by her husband. The Supreme Court held that "the insured" meant only one insured, and the phrase "the insured" referred to the insured who was responsible for causing the loss and was seeking to recover under the policy. Moreover, the Court found that National Union's policy did not conform to the standard fire policy form provided by state law. The Court held that reformation of the policy to conform with the standard fire policy form was appropriate.

In *Watson v. United Services Automobile Association,* 566 N.W.2d 683 (Minn. 1997), the Minnesota Supreme Court examined a case in which a husband and wife were in the process of a divorce when the husband intentionally burned down their mobile home. Only the husband lived in the mobile home, although the mobile home was being purchased by both husband and wife under a contract for deed. The court held that the wife was entitled to her proportionate share of the insurance proceeds. The court based its decision on the theory that insurer's policy did not conform to the minimum coverage requirements set forth in Minnesota Statutes even though such theory was not presented to the trial court. Notwithstanding the fact that the "an insured" language in insurer's policy unambiguously barred coverage for innocent co-insured, the exclusion of coverage contained in insurer's policy conflicted with the level of protection provided in the statute, and the wife was therefore entitled to her proportionate share.

In *State Farm Fire & Casualty Insurance Company v. Miceli,* 518 N.E.2d 357 (Ill. 1987 the appellate court of Illinois examined a case in which an insurance carrier denied coverage to Mr. and Mrs. Miceli, after their son, an insured vandalized their home. State Farm homeowner's insurance policy contained the following provisions:

> "Throughout this policy 'you' and 'your' refer to the 'named insured' shown in the Declarations and the spouse if a resident of the same household. . .
>
> '[Insured]' means you and the following residents of your household: (a) your relatives..
>
> Concealment of Fraud. This entire policy shall be void if any insured has intentionally concealed or misrepresented any material fact or circumstance relating to the insurance."

The trial court found that a reasonable person interpreting this language would have supposed that the wrongdoing of a co-insured would not be imputed to him. The court reasoned that a reasonable person would not understand that the wrongdoing of a coinsured would prevent recovery under the policy. Therefore the trial court held that the innocent co-insureds were covered under the policy and the appellate court agreed, despite the fact that the policy used the phrase "any insured".

In order for insurers to better protect themselves, closer attention must be paid to seemingly minute language and phrases contained in the exclusionary clauses of policies. Where there is not statutorily-prescribed standard insurance policy, the insurer would do well to avoid vague phrases like, "the insured" and use phrases such as "an insured" and "any insured" consistently throughout the body of the policy, because clearly many courts will go out of their way to find coverage for the innocent co-insured.

B. Coverage is not always compelled due to a severability of interests clause

In *USAA Casualty Insurance Company v. Gordon,*707 So.2d 1185 (Fla. App. 1998), the insured sought to recover damages sustained to his residence and personal property as a result of his wife's intentional act. According to the Florida appeals court, whether an innocent co-insured could collect insurance proceeds for damage unilaterally caused by another insured depended on whether the insurance policy provided joint or several coverage.

USAA's policy provided two distinct types of coverage: Section I of the policy described the "Property Coverages," and Section II described the "Liability Coverages." Under Section I, insureds were covered for damage to their insured property caused by various natural causes, deterioration, or vandalism. Under Section II, USAA was required to defend and indemnify an insured who is sued

by a third party for bodily injury or property damage. Section I and Section II of the policy each contained their own "exclusions" and "conditions." A final section of the policy set forth additional "conditions" that expressly pertained to both Sections I and II.

The severability clause in Section II provided: "this insurance applies separately to each insured. This condition will not increase our limit of liability for any one occurrence." The severability clause was only in Section II, and there was no similar clause in the conditions of Section I or in the section providing additional conditions applicable to both Sections I and II. The appellate court found that the trial court erred in applying the severability clause of Section II to Section I, and therefore the severability clause did not grant the innocent co-insured's recovery. The court reasoned that in this case there was no ambiguity: the interests of the co-insureds were meant to be severable with regard to liability coverage only.

Often courts analyze the language of a severability clause together with the language used to describe the insured ("an insured" versus "the insured",) throughout the contract. In *Litz v. State Farm Fire and Casualty Company*, 346 Md. 217, 695 A.2d 566 (1997) the Supreme Court of Maryland held that an insurer had a duty to defend an insured husband in an underlying personal injury action because the insurer's obligation to the insured husband and his insured wife was several and the insured husband did not participate in the excluded activity. The policy contained a provision, which was similar to the provision in *USAA v. Gordon*, and which stated: "This insurance applies separately to each insured. This condition shall not increase our limit of liability for any one occurrence."

The policy in *Litz* also used the article "an" to describe the insured in the exclusionary clauses in the contract. Therefore the Court found coverage for Mr. Litz, despite Mrs. Litz's excluded acts. The Court explained its reasoning:

> The policy in issue here specifically bars coverage for bodily injury arising "out of business pursuits on *an insured.*". . . To the extent that Pamela Litz , an *insured*, engaged in a "business pursuit," she is not entitled to coverage with respect to the tort suit. . . As I read the policy language, its plain meaning leads to the conclusion that *an* insured's business pursuits may result in denial of coverage to that insured, but not to all other persons insured under the same policy.

The Court also stated that the insurance policy contained an explicit severability of insurance clause specifying that the insurance was to apply separately to each insured. This provision, the Court reasoned, was a clear reflection that the parties intended the insurance policy to provide coverage for each of the named insureds separately. In this case, the inclusion of a severability of interests clause meant that the insurer owed coverage to the innocent co-insured husband.

IV. How coverage of the innocent co-insured plays out in various scenarios

A. H burns down the marital home. Is W covered?

In *Howell v. Ohio Casualty Co.*, 124 N.J. Super. 414, 307 A.2d 142 (1973), *modified*, 130 N.J. Super 350, 327 A.2d 240 (1974) (per curiam), the appellate court affirmed the lower court's determination that the fraud of a husband in committing arson did not preclude his innocent co-insured wife from recovering under their fire insurance policy. The appellate court reached its decision irrespective of whether the property or contract interests were joint or several. Rather, the court held that the "significant factor" was the "responsibility or liability for the fraud – here, the arson – is several and separate rather than joint, and the husband's fraud cannot be attributed or imputed to the wife who was not implicated therein." Additionally, the *Howell* court noted that, while not controlling, ambiguities in the policy language helped to support its conclusion. Specifically, the policy listed the "named insured" as the husband "and/or" plaintiff wife. The phrase "and/or" was deemed ambiguous by the *Howell* court, and the court looked to the reasonable expectations of the insured to determine that the fraudulent conduct should not void the policy as to the innocent wife.

B. Is the innocent co-insured covered when his or her spouse intentionally destroys their automobile?

When one spouse destroys an automobile, some courts look not only to the language of the policy, but also to whether or not the vehicle was marital property, in deciding whether or not the innocent co-insured spouse is covered. Where a truck that was co-owned by husband and wife was intentionally destroyed by a husband, his wife could recover insurance proceeds for the loss of the truck, as long as she could show she had an insurable interest in it. *State Farm Auto. Ins. Co. v. Raymer*, 977 P.2d 706 (Alaska 1999). The Supreme Court of the state of Alaska concluded that the wife had a sufficient beneficial interest in the truck to give her an insurable interest, even though she was not a legal owner of the truck.

C. Coverage for the innocent co-insured parents where a child commits an excluded act.

In *Safeco Insurance Company of America v. Robert S.*, 70 Cal. App. 4th 757, 82 Cal. Rptr. 2d 880 (1999), the California Court of Appeals examined a case in which a sixteen-year-old boy accidentally shot and killed his friend, also a minor. The teenager, Kelly S. found his mother's .22 caliber Beretta handgun in the pocket of a coat in her closet. Kelly removed the clip from the handle of the gun and pulled the slide back, which caused the hammer to be cocked. Believing that the gun was unloaded, Kelly held the gun straight out, pointed it over his friends' heads and pulled the trigger. Kelly's friend Christopher was struck by a bullet and killed. Christopher's parents filed a wrongful death suit against Kelly and his parents.

Safeco insured Robert S., Kelly's father, under a homeowners insurance policy, under which Velvet S., Kelly's mother, and Kelly were also insured. Safeco filed a motion for summary judgment in July 1996, contending that it had no duty to defend or indemnify the insureds because coverage was precluded by law and by the "illegal act" exclusion in the policy. The trial court granted summary judgment in favor of the insureds on the basis that the illegal acts exclusion was ambiguous. The provision did not indicate whether it was meant to encompass unintentional acts in addition to intentional acts. The appellate court reversed the trial court's decision. The appellate court reasoned that the exclusion for illegal acts would be rendered superfluous and redundant if it were interpreted as excluding only intentional illegal acts, which would merely be a subset of those intentional acts already removed from coverage by other exclusions.

The appellate court also noted that under the language of the policy at issue which excluded coverage for liability "arising out of any illegal act committed by or at the direction of *an* insured," coverage is also precluded for innocent co-insureds, such as Robert and Velvet, even though their theory of liability is based on the theory of negligent supervision. *Id, citing Fire Ins. Exchange v. Altieri,* Cal App. 3d 1352, 1360-1361 (1991); *Western Mutual Ins. Co. v. Yamamoto,* 29 Cal App. 4th 1474, 1486-1487 (1994).

In *Fire Insurance Exchange v. Altieri*, 235 Cal. App. 3d 1352, 1 Cal. Rptr.2d 360 (1991), the California Court of Appeals held that an insurer was not liable where the policy excluded coverage for bodily injury intended or expected by "an" or "any" insured, and where a fifteen year old insured intentionally assaulted another minor, causing him serious injuries.

In both of these cases, the courts did not use true innocent co-insured analysis in determining whether or not there was coverage. The parents were potentially liable for negligent supervision, and were therefore not innocent. In other jurisdictions, however, courts decide cases of negligent supervision by reasoning that the parents were innocent co-insureds.

In *Montgomery Mutual Insurance Company v. Dyer,* 2001 U.S. Dist LEXIS 21484 (W.D. Va.), accepted by *Montgomery Mutual Insurance Company v. Dyer,* 170 F.Supp. 2d 618 (W.D. Va.), Gregory Dyer burned down the home of his mother, Diana Dyer, believing that he was Jesus Christ. The court found that Gregory was mentally ill, and that Diana was an innocent co-insured. The court held that the Dyers' insurance carrier owed Diana Dyer coverage, but it did not focus on Gregory's mental illness, or on his mother's failure to supervise him. Instead the court based its decision on the language of the policy. The court reasoned that "who," following "an insured" in the policy narrowed the focus of the exclusion to those insureds engaging in the conduct that excluded coverage for an otherwise insurable loss. Therefore Diana Dyer's loss was not excluded.

D. The special case of firearms

In *Allstate Ins. Co. v. Freeman*, 432 Mich. 656, 443 N.W.2d 734 (1989), the Michigan Supreme Court held that a husband who negligently made a gun available to his wife was not covered where the intentional act exclusion referred to "an insured." The Court held that "an insured" unambiguously refers to "all" or "any" insureds under a homeowners' insurance policy.

The Tennessee Court of Appeals reached a different conclusion in *Musser v. Tennessee Farmers Mutual Insurance Company*, 1989 Tenn.App. LEXIS 749. In that case, the Plaintiff obtained an automobile insurance policy from the Defendant. The policy was in her name only and insured a 1984 Nissan Stanza which was titled in her name as well. Subsequently the Plaintiff married William Musser who, according to the Plaintiff suffered an "insane attack", which resulted in an assault upon her and the firing of 30 rounds from a semi-automatic machine gun into her car. She testified that her car was essentially destroyed as a result of the numerous bullet holes throughout the interior and exterior of the vehicle.

The appellate court chose to analyze the case under the "Innocent Spouse Rule." It held that the insurance company owed the plaintiff coverage. The appellate court reasoned that the policy was in the Plaintiff's name and was purchased when she was single. Moreover, the car was titled to her alone and she had absolutely nothing to do with the destruction of the property. Since the destruction of the car was accidental as to her (she did not intend, and could not have predicted that her husband would spray her car with bullets), denying coverage would produce an inequitable result.

In *Musser*, the Tennessee court of appeals analyzed an automobile insurance policy. This was not however, a relevant factor in the court's decision. The court chose to analyze this case under the "Innocent Spouse Rule" as announced in *Ryan v. MFA Mut. Ins. Co.*, 610 S.W.2d 428 (Tenn.App. 1980). In Ryan, the Court permitted a husband, a co-insured, to recover for his property which was destroyed by a fire intentionally set by his wife. Thus the court focused on the language of the policy and the name that appeared on the title, not the kind of property that was insured.

The issue of negligent entrustment can arise in cases involving firearms, even where the insureds are spouses, and not children. *Allstate Insurance Company v. Worthington*, 46 F.3d 1005 (10th Cir. 1995), was a suit that arose out of Richard Worthington's kidnapping of hostages and fatal shooting of a nurse. His wife was sued by the victims and their survivors on claims that she negligently entrusted weapons to her husband and failed to warn the potential victims. Allstate asserted that summary judgment for the defendants was improper because (1) the insurance policy unambiguously provided that because the husband's intentional acts were not covered under the policy the wife's negligent acts also were not covered; and (2) the wife's actions or omissions also were not covered, and (3) the innocent co-insured case law did not afford coverage to the wife. The court reasoned that because its decision on the first two points it did not need to even address the issue of the innocent co-insured.

The court reasoned that the language of the policy was ambiguous as to whether Allstate had a duty to defend and indemnify the wife when her coinsured husband was not covered because he was engaged in an intentional or criminal act excluded under the policy. The particular exclusionary clause on which Allstate relied did not include any reference to "an insured" or "any insured." The clauses excluding coverage of acts or omissions while insane or lacking capacity or control did explicitly refer to "an insured person," the criminal act clause referred to "the insured person."

Applying Utah law, the circuit court held that Allstate had a duty to defend the suits alleging the wife's negligence. The circuit court rejected Allstate's argument that it should look to the "underlying cause" of the injuries to determine whether the wife was covered. The circuit court distinguished this case from other cases where the policies at issue referred to "an insured", "any insured", or even "insured." The court found that Utah courts had not specifically adopted or rejected the view that negligent acts or omissions connected to intentional acts of other insured were never covered by homeowner's liability policies. Therefore, based on Utah policies of construing exemptions against the insurance company, the circuit court affirmed the district court's summary judgment in favor of the insured. The circuit court noted that if Allstate wanted its homeowner's insurance policies to exclude coverage for all insured persons for an excluded act by any insured person, it could do so by careful drafting.

E. Misrepresentation on the Insurance Application

In *Jung v. Nationwide Mutual Ins. Co.*,949 F. Supp. 353 (E.D. Pa. 1997), the insured Mrs. Jung admitted that her answer to the question about prior lawsuits and judgments was false at the time she signed her insurance application. However, the Jungs contended that there was no bad faith representation because the application was filled out by the agent and that Mrs. Jung did not even look at the application before signing its. The court rejected this argument, finding that Mrs. Jung could not avoid her responsibility to review the application before submitting it. The fact that she failed to review it rendered her act of signing the application bad faith under Pennsylvania law. Therefore, Mrs. Jung's claim that someone else filled in the application could not, as a matter of law, defeat rescission.

Specifically, the application asked, "Has insured or family member been sued, filed bankruptcy, had repossession/judgment within the last 7 years?" The question was followed by the letter "N," for no, and the application was signed by Anne Marie Jung. At the time the application was signed, there were nine lawsuits in the Court of Common Pleas of Lancaster County which had been filed or were pending within the past seven years, and to which the Jungs were defendants. Mrs. Jung admitted that the answer to the question regarding lawsuits and judgments was incorrect.

Mr. Jung did not sign the application which contained the material misrepresentation. Even though he did not sign the insurance application, he was not entitled to any recovery under the policy. The district court did not address the issue of the innocent co-insured. Instead, the district court applied Pennsylvania law which allowed the insurance company to rescind the policy if (1) the application contained a misrepresentation, (2) the misrepresentation was material to the risk being insured and (3) the insured knew that the representation was false when made, or the insured made the representation in bad faith. Because this law on rescission was available, the court did not have to address the issue of the innocent co-insured.

Unlike *Jung,* the Superior Court of New Jersey examined the issue of the innocent co-insured in deciding *IFA Insurance Company v. Trabucco v. Fede,* Superior Court of New Jersey, decided February 26, 2002 (unpublished opinion). The Superior Court affirmed the grant of summary judgment in favor of the insurance carrier plaintiff, ordering the contract of insurance to be rescinded. The court rejected a son's contention that he was an "innocent third party" and that his mother's policy should be declared void only against the insured, his mother, since she was responsible for the misrepresentation or omission of the son's name as a resident of her household. The court held that the "innocent third party" doctrine did not apply to an accident in which a member of the insured's household is injured in a collision unrelated to the insured vehicle.

Under New York law, an "innocent co-insured" is entitled to recover on a homeowners policy claim in very limited circumstances. In fact, the district court for the Northern District of New York noted that the "doctrine is applicable only in a rare situation where (1) no material misrepresentation has been made in the application, and (2) one insured commits arson upon the premises without the other insured's knowledge." *Courtney v. Nationwide Mutual Fire Insurance Company,* 179 F. Supp 2d 8 (N.D.N.Y. 2001). In *Courtney,* therefore, the insurer was entitled to rescind homeowner's insurance policy where the insurance application contained material misrepresentations upon which the insurer relied; the contention that insured signed a blank application did not matter.

As these cases illustrate, in most jurisdictions insurers may rescind policies where the insured has made a material misrepresentation on the application for insurance, even where there is an innocent co-insured.

V. Conclusion

When dealing with a claim involving an innocent co-insured, any practitioner must assume that the courts will try to find coverage. In many instances, the courts will give the innocent co-insured two bites at the apple. First, the courts will look at those two or three letter words modifying insured. If that phrase forecloses coverage, then the courts will examine the severability clause.

Under either scenario, clarity is the key. Clearly drafted phrases and clauses are the best defenses to claims by the innocent co-insured.